"Activist Profiles & Playbooks"

Tuesday, March 24, 2020

Audio Archive

With more activism than ever, it's important to be able to identify who the activists are - and what makes them tick. Join these experts:

- **Anne Chapman**, Managing Director, Joele Frank
- **Bruce Goldfarb**, President & CEO, Okapi Partners
- **Damien Park**, Managing Director, Spotlight Advisors LLC
- **Patrick Tucker**, Managing Director, Abernathy MacGregor

John Jenkins, *Editor, DealLawyers.com:* Hi, this is John Jenkins, editor of DealLawyers.com. I'd like to welcome you to today's program, Activist Profiles and Playbooks.

Before we begin, I want to take a moment on behalf of our panel, myself and all of my colleagues at CCRcorp to express our sincere best wishes for you and your families. We hope you and yours are safe and well during this extraordinary time.

It's not news to anybody that shareholder activism has been very robust in recent years, and chances are that the recent market crash is only going to ramp up activist activity once some sense of normalcy returns to our lives. Since that's the case, it's pretty important that we keep up to speed on the latest trends and tactics in activism.

We've got a terrific panel here to do just that. Joining me are Anne Chapman, who's managing director from Joele Frank. We have Bruce Goldfarb, who's CEO of Okapi Partners, his colleague, Alexandra Higgins, who's a managing director there. Damien Park, who's a managing director at Spotlight Advisers. And Patrick Tucker, and he's a managing director at Abernathy MacGregor.

With that, I'm going to turn it over to Anne to lead off today's program. Anne?

What are the lessons from 2019's activist campaigns?

Anne Chapman, *Managing Director, Joele Frank*: Thanks, John. I'll start off with lessons learned from 2019, which, quite frankly, at this point seems much farther in the rear-view than just a few months ago. Let's start out with a few steps to just level set.

The number of campaigns last year actually decreased, so there were a total of 187 globally versus the 227 in 2018, down about 17 percent. It's worth noting that 2018 was a high mark, so last year's level was pretty consistent with the yearly average.

Also, of note, there was a slight uptick in non-U.S. targets. The U.S. only accounted for 60 percent of those contests or campaigns. They were at 70 percent in '18.

The mix of demand from activists, 48 percent of the activity last year was board related, which was up about 20 percent. Also, a strong contender were the M&A theses, about 47 percent of all the 2019 activity. Worth noting that there were a record 99 campaigns that were specifically focused at some sort of M&A, generally speaking either to sell off a company, to suggest a target, or even to push the brakes or get better terms on an existing M&A option.

Business strategy and balance sheet activism again last year were pretty minimal, 8 percent and 10 percent respectively. It could have something to do with the general positive market conditions that were in effect then, or that management had taken a lot of their own activist action along those areas in recent years.

Worth noting that those campaigns actually going to a proxy fight, also down, 59 versus 105 the year before by some counts, and about 46 percent of those were settled before a vote which tracks the average, again, over the past five years.

I think, as a former shareholder, it's really interesting to keep track of the board seats that continue to be won through settlements versus proxy fights. Over the last five years, 82 percent of those dissident seats are won through a settlement.

One other stat that caught my eye was the dramatic increase in long slates, where 50 percent or more of the incumbent board were targeted for replacement. There were 17 of those in '19 against 7 that took place in 2018. Interesting stats because then if you look at the total board seats won in those long slate campaigns, that actually was lower last year than it had been the year before. More nominees, perhaps not as much success.

That's sort of level setting with the statistics. Now, on to tactics and creative approaches, which I think is much more interesting. Last year certainly saw a number of instances that weren't the typical playbook. ValueAct, for example, doing an information sharing agreement at Citigroup, where they didn't have a board seat.

I think one article in "The Wall Street Journal" coined the term "quick peace treaties." These are instances where there was a quick agreement or truce, perhaps temporary, instead of the more long-drawn-out, perhaps resource-intensive fights, without objection. If this will become a trend, I think, remains to be seen.

There were a couple that I thought were noteworthy, so AT&T, which included a review of the portfolio, similar modest changes in agreements at Emerson Electric and Marathon. The activists and the companies are very specifically not calling them settlements, so it allows the activists to provide some advice and recommendations. It's noteworthy that there is no formal agreement, which would end a campaign with some legally enforceable provisions.

No surprise to all of us is that generally these would work best if the company management agrees. I was struck by the act that AT&T's CEO Stephenson acknowledged in an article that it seemed that the company had a 100 percent alignment with Elliott Management and noted that they had really good insights and thoughts, perhaps in addition to those that paralleled what the company was already doing. Are there kinder, gentler activists? Perhaps that's a stretch, but that was certainly noteworthy.

Something else I thought was a very notable development was the continued focus on ESG. The activist focus perhaps mirrors the trend with investors, particularly those index investors. The launch of activist funds focusing on E&G, including Impactive Capital's

launch, the alums from the Blue Harbour Group, with that $250 million anchor investment from CalSTRS, ValueAct and the Spring Fund, which Jeff Ubben is now focusing specifically on. They've stated that they're investing on E&F factors like carbon pricing, and that certainly was noteworthy.

A number of the activists adding head of investment stewardship. Elliott and Third Point did this specifically. Then there are campaigns - the London activist hedge fund TCI has stated publicly they'll start voting against directors for a lack of carbon dioxide emissions disclosure and less specific and targeted, but it's worth noting that other activists are focusing on those ESG issues, like diversity carbon emissions, as part of their campaigns at companies.

Several have noted that this is just a logical extension of the governance focus they've had in years past. Again, I don't know that it's any accident that it really mirrors what the large investors, particularly the index funds, has stated as their focus on holding boards accountable.

That's sort of where we were in 2019. How appropriate those lessons or those observations are in this current brave new world will be interesting to see, and that's a great segue to let Bruce talk about what we think now will happen in 2020.

What can companies expect from activists this proxy season?

Bruce Goldfarb, *CEO, Okapi Partner:* Anne, thank you very much. Always interesting to appreciate the history to understand what is happening today, and the challenges that we face when looking at prognosticating are amplified in an environment ripe with uncertainty.

With that in mind, many of the ideas that were brought forth in campaigns in 2019 and earlier by activism, by activists, are still the basis for the campaigns of 2020. Companies can still expect that activists are going to be evaluating companies with the perspective that they bring as deep value research investors look towards which companies are exhibiting their lack of cover by a more buoyant, positive market.

As the markets have increased volatility, some activists have indicated that this is a season where there are buying opportunities that - in companies in which they may have believed were potentially overvalued before, as well as opportunities to say that within the crisis that companies are seeing - there's truly a need for enhancing a board, providing operational guidance for companies to navigate through the challenges.

Although Anne also indicated that campaigns decreased in 2019, that's still true in terms of the number of fights that have started in February and March 2020, relative to the same period in 2019. We were looking at data from FactSet, and my colleague, Alex Higgins, who is online, helped take an evaluation of this data.

While the number of these campaigns have decreased over that period from, say, 55 to about 32, the number of campaigns to push companies to maximize value actually increased. While it's a challenging time to tell companies to maximize their value - and maybe that's an obvious suggestion - how to do it is going to be whether or not an investor has the opportunity to thread the needle appropriately.

Although proxy fights are slowing down, in terms of numerocity, the statistics never tell the full story. As I've mentioned, activists are finding opportunities within companies, potentially situations that they've looked at as targeted companies over the last few years and now are looking again and bringing that lens to bear in challenging times.

Many activists are also seeking out ways to engage companies beyond a proxy fight or having a willingness to dialogue that may ultimately lead to the settlements, whether they would be as Anne had described, reporters talked about quick peace treaties or other ways to work together.

In the very present, we are experiencing situations where companies and their investors are sitting down and willing to work together. In some instances, we're going back more than a decade in terms of how companies are viewing potential activism, quicker settlements in an almost "what's the harm" process, as opposed to a total discussion of where are the benefits, recognizing that there are so many other areas that need to be examined that a proxy fight all the way through a campaign to a vote can take months of time and attention, that may be really required to focus on operations.

Number of activists also recognizes the barriers that may be added to a campaign this year, including companies coming out very aggressively in their press releases when an activist approaches, effectively saying, "How dare you in these times make us go through a proxy fight?"

Then the activists, recognizing as well that there are some regulatory tailwinds that the SEC has provided to companies in terms of allowing companies to be a little more flexible in terms of setting their date, in terms for the meeting, in terms of having a location for the meeting, in terms of having virtual-only meetings, which in the realm of a contested election are sort of something that has not been tested.

While the market tumult makes it easier for activists to make their case to other shareholders, it also makes it more challenging in some instances to reach the shareholders. It makes it more challenging to communicate with investors among each other, for companies to set up in the kind of dialogue with their investors as people are working more remotely and trying to work out the challenges that that brings.

We think that when the market stabilizes, even at these lower levels, there may be more opportunities for activists to look at even more targets that weren't able to weather the crisis well, and so the outlook for the second half of 2020 and potentially into 2021 will be very much impacted by our current environment.

I note that there have been a number of the most active activists who have really not stopped in their evaluation of companies, large and small, and that there are a number of smaller activists who have really said, in this environment, "can I run a campaign?"

It's an unusual environment, but companies should expect that within this environment, they have to be very mindful of communicating their message to their investors. Their engagement program should be as fulsome as possible.

Companies need to articulate their plan to their investors, including some articulation of the risks of the current pandemic, and just need to be ready that investors are not necessarily going to give companies a pass because of the pandemic. It will be a challenge to the company's operations, but there's an expectation that a management team who could win a proxy fight will have to be able to demonstrate that they have earned their stripes during this season.

With that, I recognize that there are a number of different activists who have different kinds of views on these situations. I want to turn it over to Damien to talk about that activist universe.

Who is in the universe of activists?

Damien Park, *Managing Director, Spotlight Advisers:* Thanks, Bruce. I appreciate it. As always, you've got some great insights and some great advice.

I should have the qualifier that - everything that I'm going to refer to is valid up until at least yesterday or maybe even early this morning because things are changing so rapidly, obviously, in the economy and the markets and the activist universe.

I take a step back, though. I think from December of 2019 through March of this year, we were gearing up for it to be our busiest season ever. We thought it was a lot of activity going on behind the scenes and engaging with companies and a lot of different types of investors engaging with companies and pushing for change. We ultimately expected a lot of that to turn into nominations and the submission of nomination notices, which are happening right now.

This is the time of year when most of those nomination notices are being submitted to companies for meetings that are taking place in June, late June, July, and late July, or gearing up for a nomination notice for those meetings that might take place in August sometime.

From what we've seen, there's some activity where some of the smaller activists are re-evaluating whether or not they want to even nominate. If they do nominate, it's to put their foot in the door and then decide over the next 90 to 120 days whether or not they really want to carry through with an activist campaign for a variety of reasons; One is obviously because of the time and the commitment to doing it, and the energy that is taken away from running a portfolio, and, of course, the cost associated with running a campaign and the disruption both to the investor, as well as to the company.

We'll have to just wait and see over the next few weeks how that plays out. Even if these activists do go forward and nominate, there's a serious question of whether or not their campaign that they had prepared to run several weeks ago is still valid.

For example, an investor pushing a company to do better capital allocation or to do a buyback or distribute dividends is a very difficult thing to demand in this environment. The same with M&A activities, whether or not you want them to sell some assets or to restructure a company. It's a very difficult time, and it'll be extremely difficult to sell assets in this atmosphere, as well as refinancing debt.

I think a lot of activists are taking a step back and trying to determine whether or not their campaigns are going to be as strong as they were just a few short weeks ago.

That being said, as Bruce mentioned, I'm really just going to talk a little more about the universe of activists and who they are. Quite frankly, everybody is an activist, and every company is a potential target from an activist. The way that we look at activists as - there's kind of the dedicated activist, and those are the groups of investment firms that specifically target a company because it's undervalued or underperforming or a combination of both.

If you're able to shine a spotlight on the fact that they're undervalued and why they're undervalued, that can bring the value of that company up, particularly as you engage over time and certain changes are made in the investment universe, who recognizes that these positive changes will benefit the share price in the long term.

Those are the types of investors that will formally target a specific company. Those are hedge funds and family offices or a group of investors that come together around a singular investment idea. There are, of course, the traditional activists, like the Starboards or the Elliotts and Icahn and the others. There are also investment groups that are

forming with a single fund to target a single company, so they're setting up specific situation funds or raising capital specifically with one activist idea in mind.

What we've also seen is former CEOs, former board members and industry players that have an idea for a specific company, a specific target and how things can be fixed. Those still exist, and there's a group of those investors that just focus on those undervalued companies, target them and engage with them.

Then there's another type of investor, and that's more of the institutional style investor, where they have a portfolio of companies and investments. Oftentimes these are multi-billion-dollar investors that may find that engaging with one specific company in their portfolio can reap rewards, both in the short term and the longer term.

That universe of activists is growing, quite substantially, as we've seen over the last few years. We have a number of clients that are larger institutional investors engaging on one-offs with their portfolio companies in which they've been investors for a long period of time.

We've also seen more strategic type of activism. One example we have is we had a client who was an Israeli company last year that had a 10 percent interest in a Canadian company, and they weren't happy with the strategy and the direction of the management and the board of the Canadian company.

They proceeded to nominate people to the board of directors in the hopes that they could influence the strategy of their sizable investment. That was sort of a strategic investment from one operating company to another, and we've seen a few more of those situations over the last year or so.

That's the universe of the activists. As I said, I think everybody's an activist these days, and certainly every company continues to be a target. We'll see how this plays out over the next 90 to 120 days, I think. What we've seen is a couple of the more established activists - just over the last few days - trying to raise capital around some special situation funds, where they intend to double-down on their investment in their portfolio.

They might select a handful of their portfolio companies and set them up in a special situation fund. They're soliciting additional investments from their current LPs. They are waiving their management fee and waiving their performance fee until 100 percent of that investment in the special situation fund is returned to investors. Going forward after that, they'll take a 20 percent or whatever return. It's very interesting to see how some of the more established activists are doubling-down on their portfolio and their investment.

I'd just say one last thing before I turn the call over to Patrick. I think we can draw a number of lessons from what happened in the global financial crisis. What we saw then was that a large number of activists that were underwater and were going to have to struggle to get back up to their high watermark had a number of their very smart analysts or portfolio managers leave their firm to establish their own funds.

We saw the emergence of a number of new activists coming out of that global financial crisis. I suspect we're going to see the same thing here. Next year may indeed be a whole other world with a whole new group of activist investors that are raising capital, and we'll see whether they're raising it around specific ideas or whether they're building portfolios for some dedicated activism. It'll be very interesting to see how that plays out. All I can say there is stay tuned, and we'll have more to say about that.

Now, I'll turn it over to Patrick to talk a little more about the different styles and types of small- and large-cap guys that are out there.

How does large cap v. small cap activism differ?

Patrick Tucker, *Managing Director, Abernathy MacGregor*: Sure. Thanks, Damien. That's a really helpful analysis, when it seems to be we're finding activists at every turn here.

I'll spend a few minutes here talking about the differences between large-cap activism and small-cap activism, probably more interested in small-cap activism these days as everybody feels like they're in that bucket.

Starting an overall framework, the easiest way to think about it is to just follow the money. If you think about large-cap activism, it's a much more expensive endeavor. You end up with smaller stake sizes, usually somewhere on average between 1 percent and 3 percent more often. They're more consistently under the 5 percent thresholds.

The result is also you see fewer, what we might call, real players on the high-end and large-cap. I think Elliott, Starboard and Icahn dominate many of the headlines on that front.

The other result is you see a lot more of behind the scenes work, as this type of engagement is not as public. If it is public, it's not as a prolonged public engagement as we see in the small-cap. These are what you might call more of a private negotiation versus a holdup.

Another key factor here is, in the large-cap, you see what you might call a predictable shareholder base. The institutional funds that hold them are funds most people have seen and dealt with, and really fall in an almost predictable order these days across many of the large-cap companies.

As part of that, you do see real passive engagement. The further up the chain you go, you get more active engagement and relationship-building with the Black Rocks, Vanguards and State Streets of the world, which is a key consideration and difference when you get to the small-cap.

It almost goes without saying, you do see better boards on the large-cap, and I think that results to what Anne was talking about here, of the way negotiations have gone. AT&T and Twitter were very interesting engagements this year in what I've heard some people call a sort of detente in which both sides reach some sort of an agreement to do certain things, not a settlement. You can also see a set-up where the terms of this standoff are revisited a year or two years down the line, so large-caps are going to be under multi-year scrutiny in some respects.

Really what we're seeing in the weakest point for large-caps is on CEO transition. Given how boards are scrutinizing their own companies and how CEO and management teams are running them, the trend you might argue is you see some opportunity for activists on CEO weakness or CEO change.

One other key factor that we're starting to see on the large-cap front is the role of private equity. This was a factor in the Twitter pseudo-settlement, and it's something we will continue to see, especially as they're looking to put capital to work. We will see private equity feel more comfortable working alongside activists. We've seen that a number of times with Elliott and Sarissa and a number of other funds. I think that's a trend we'll continue to see pickup.

On the small-cap side, the difference here, again, if you think about the money, the stakes go up. You can see 4 percent, 9 percent and even higher stakes accumulated much quicker. You see a lot more players. The key here on the small-cap side is some are very

real. Elliott and Starboard do invest in the small-cap and mid-cap space. You also see a lot of what you might call un-practiced players and activists pursuing tactics that are different or sometimes questionable.

Then you also see new or first-time players. To Damien's point, somebody who's setting up a fund and looking to put a few wins under their belt and practice their approach, you might see them more often in the small-cap space first. You also see these fights are much more public - 64 percent of small- to nano-cap engagements are public versus large-cap engagements.

They're more of a push in terms of the overall approach than a nudge. The shareholder base is another key consideration there in which you can end up with a much more event-driven shareholder base. The other fact is passives are harder for small-caps to reach, in terms of an active ongoing engagement.

They're also not as practiced in understanding how to reach them, so they're often overlooked in terms of an ongoing investor relations engagement program. I think especially established activists are able to use their relationships from both large-cap and small-cap fights to pursue fights that resonate with those passive funds, as well. It's a key factor to consider. The results in the small-cap space is you see a movement to faster action.

As Bruce was talking about, really quick settlements, where boards make an assessment and don't want to pursue the cost of a proxy fight. The other reverse is, if there is going to be a proxy fight, almost assuredly it's going to be in the small-cap space. This is really where, as we see proxy fights go down, we see most of them taking place in the small-cap space.

The last thing I will say is, ESG is a factor and a consideration and part of the conversation much more on the large-cap side than it is on the small-cap side. One interesting trend we started to see last year was practiced and professional activists actually bringing some of their ESG insights to the small-cap and mid-cap space and looking to further their own credentials, but also offering real and credible advice to some of their engaged targets. It's an interesting way that they're bringing best practices down to the rest of the market.

With that, I'll end my remarks and turn it back over to the moderator.

Jenkins: Thank you very much. I'd like to thank the panel for once again providing a great overview of activism and what companies may be facing this year. Thank you to everyone who joined us for listening today. This concludes today's webcast.